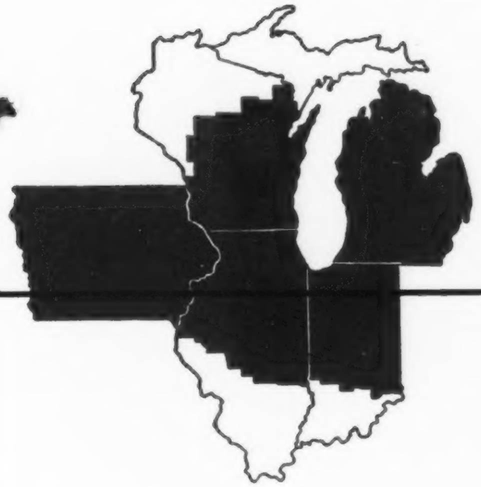
A review by the **Federal Reserve Bank of Chicago**

Business Conditions



1957 June

Contents

THE Trend OF BUSINESS

The current business situation is being described widely as one of *rolling adjustment, balanced cross currents* and *horizontal recession.* These colorful phrases are the business journalist's way of saying that the picture has been one of stability. Furthermore, recent evidence suggests no major change is in the offing — neither a sharp upsurge nor a general decline appears imminent.

Investment: neutral?

The forward thrust of business in 1956 was powered largely by expanding capital outlays. In recent months some fears had developed that this sector would weaken and provide a drag on the economy as 1957 progressed. However, a recent survey of business plans for capital spending during 1957, taken by McGraw-Hill, has helped to still concern that business firms have been adjusting these programs downward. The survey indicates that plans to purchase new buildings and equipment were maintained, at least between the late fall and the March-April period when the new figures were gathered. It was during the intervening period that the development of adequate capacity and tighter profit margins became apparent in many lines.

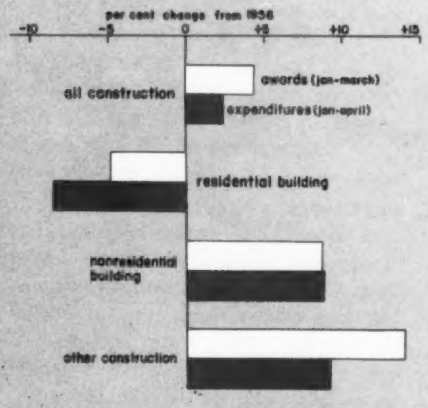
The firms surveyed expect to spend 12 per cent more than last year, a year-to-year increase which should maintain the current rate of outlays through 1957. The report also documented sizable advance planning for subsequent years but indicated that a higher proportion would be devoted to replacement of existing facilities rather than expansion.

Stability in investment type expenditures is indicated also by construction contract award information tabulated by F . W. Dodge. In the first quarter, total awards bettered the record period in 1956 by 4.4 per cent nationally and by 0.5 per cent in the Seventh Federal Reserve District. This level of awards should maintain the value of construction put in place near the April rate of 44.7 billion dollars, at least for a number of months.

For the January-April period the value of new construction was 2.4 per cent above the year-ago figure. Increases in nonresidential building and public works more than offset declines in residential and farm building. Detailed award data suggest a continuance of these offsetting trends.

Production of machinery and equipment has been well maintained. There has been some slackening in the high-flying construction machinery industry, mainly as a result of the

Contract awards show larger gains than construction outlays



Note: Awards data from F. W. Dodge.

slower than expected acceleration of the enlarged Federal Aid highway program. However, farm machinery sales seem to be improving in line with enhanced prospects for farm income, and other types of outlays are holding up well. Truck production has been about 100,000 per month — near the year-ago rate. Order backlogs for machine tools and railroad equipment have been dropping for several months but still are at high levels, and production has been maintained. Backlogs for commercial aircraft, as a result of the approach of the jet age, and for giant tankers, largely because of the Suez crisis, are sufficient to keep these industries operating at high rates.

Question marks!

With capital investment indicated to be a relatively stable factor in the outlook, attention has shifted to three important areas of uncertainty: (1) the degree to which consumers live up to their steadily rising incomes, (2) changes in the level of Government spending and (3) the desire of many business firms to stabilize, or reduce, inventories.

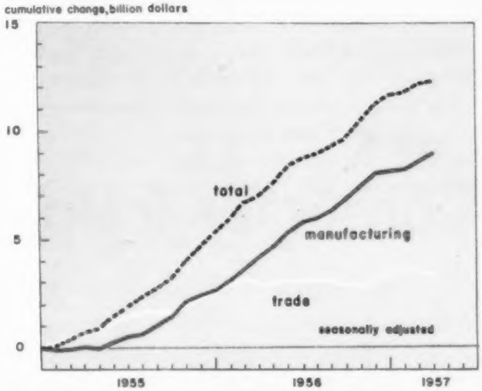
Consumer buying. Personal income has been at a level 20 billion dollars, or about 6 per cent, greater than last year. In the first four months, retail sales bettered 1956 by almost exactly the same proportion.

Weakness in consumer buying has been reported in the case of automobiles and household goods. But, although unit deliveries of new cars were 4 per cent less than in the January-April period in 1956, the dollar volume of sales of automotive dealers was 7 per cent *higher*, largely because of higher prices, more gadgets and a strong used car market.

Department store sales were somewhat disappointing in April, possibly as a result of unfavorable weather conditions. However, early May appeared to be producing a recovery. Gains in most Midwestern centers were substantially greater than for the nation as a whole.

Government spending. Budget cutters have been hard at work attempting to pare down Federal expenditure authorizations for the coming fiscal year. But it is possible that any

Most of the inventory build-up has occurred in manufacturing during the past year



budget cuts would only slow down the increase in outlays which began in mid-1956.

From the second quarter of 1956 to the first quarter of 1957, Federal purchases of goods and services rose by 3.7 billion dollars to 49.8 billion on an annual rate basis. This development was traceable to larger national security outlays, which, in turn, are said to reflect primarily increased prices rather than any enlargement of programs. The current budget proposal provides for a further increase.

Inventory accumulation. The book value of business inventories increased by 1.5 billion dollars in the first quarter. Higher stocks at the manufacturing level more than accounted for this rise. Holdings of retailers and wholesalers actually declined, allowing for the usual seasonal pattern. Moreover, the increase that did occur apparently reflected higher prices, rather than physical gains. Although average wholesale prices of industrial goods have been fairly stable since mid-February, inventory figures had not fully reflected earlier price advances.

Various surveys of business intentions depict a more cautious inventory policy. Many firms have launched drives to reduce costs and maintain sagging profit margins. Unnecessary stocks of purchased materials, of course, represent an

extravagant use of funds during a period of tight money and quick deliveries on most commodities.

Stable investment outlays and rising demand from the users of finished goods, that is, individuals and governments, suggest that any overall reduction in inventories is likely to be quite limited. The present situation represents a re-evaluation of inventory positions which had been based, in many instances, upon the existence of capacity bottlenecks. In the past year, these have been largely alleviated.

Consumer instalment credit: issues in perspective

- **What forces underlie growth in instalment credit?**
- **Has consumer credit contributed to or interfered with the achievement of stable economic growth?**
- **Is such credit self-regulating in the sense that the interests of lenders and borrowers afford effective safeguards against harmful "excesses"?**
- **Does consumer instalment credit differ so greatly from other types of credit that general monetary controls are relatively ineffective in stimulating or retarding its use?**
- **What are the practical advantages and disadvantages of selective control of instalment credit?**

These are major issues dealt with at length in the recently completed Federal Reserve study, *Consumer Instalment Credit.* What guides to judgment on these questions does the Report supply?

Growth: past and prospective

Outstanding instalment debt has increased during the past four decades by an average of 10 per cent yearly, three times the rate of advance for all the other types of private indebtedness taken together. But the growth has not been steady. Three distinct surges are evident: during the Twenties, in the years of recovery from the depression and, most recently, since the war. The volume of instalment debt declined sharply with the onset of the depression in the early Thirties and in the war years of the Forties.

Most obvious, of course, among the forces associated with the growth of instalment financing has been the widening ownership of the automobile. But other factors have been at work also: suburbanization and the trend toward home ownership, the increase in leisure time, the movement of women into the labor force, the spread of mass production and, highly important, changing attitudes toward debt.

Many of these relationships have worked in reverse, too. Availability of consumer credit and the development of suitable institutional arrangements promoting its use have smoothed the way for more widespread auto ownership

and encouraged home ownership. And time buying has been a factor in bringing mechanization into the home, freeing housewives for jobs in industry.

Consumers have learned that taking on instalment obligations does not always add in full proportion to the strain on the family budget. To a significant extent, the monthly payments of principal and carrying charges displace current spending for such items as wages of domestic servants, laundry bills, movie admissions and bus fares. In short, households have been going into debt to buy assets that provide services of the kind they formerly bought directly from businesses.

Allowing for these influences, as well as the increased amount of credit needed to match rising prices of the articles financed, still fails to account for the full extent of the growth in instalment credit. Easing in terms—reduced down payments and lengthening contract maturities—in instalment lending has been another big factor. It is estimated that automobile credit outstanding today would be about 7 billion dollars, instead of 14 billion, if the conservative down payment and maturity standards of 1920 had remained in force ever since. Just since 1954, furthermore, about 1 billion dollars, or roughly a fourth, of the expansion in auto credit has come about because of easier terms.

There are reasons, though, to think that the term of rapid growth in instalment credit may be behind us. For one thing, time financing already is well entrenched in the marketing of most kinds of durables. Opportunities for further application of the instalment payment plan appear to be limited. Moreover, the amount of credit typically supplied leaves little room for further enlargement, if the value of collateral is to continue to serve lenders as a guide to credit quality. There is, of course, the chance that the inclination to overlook collateral in favor of the borrower's "credit-worthiness"—a tendency more and more apparent in recent experience — will gain further ground. If it should, a large additional expansion could occur.

It is difficult, as the Federal Reserve report makes clear, to determine whether instalment credit has been one of the causes of economic growth, taking the form of an enlargement in the stock of consumer capital, or whether the effect has been the other way around. Probably the two tendencies have been mutually interacting. Certain it is in any case that expansion of instalment indebtedness and buoyancy in the markets for consumer durables have gone hand in hand. If this has meant some diversion of purchasing power from services and nondurables to durable goods, then presumably consumer preferences have dictated it and instalment credit has facilitated it.

Instalment credit and stability

Wholly apart from the matter of long-term movements in the volume of outstanding instalment credit, what about shorter-term fluctuations? Have rapid expansions and sharp contractions aggravated ups and downs in general business? Or, have they been partially offsetting to expansions and contractions emanating from other sectors, a sort of automatic stabilizer?

The evidence is not easy to size up, but the report concludes that, on balance, expansion of instalment credit has added fuel to booms, and, in times of recovery, upturns in credit outstanding have begun early enough to be counted among the forces contributing to recovery.

The April issue of **Business Conditions** presented a highly condensed guide to some of the highlights of the first three parts of the study, **Consumer Instalment Credit**, released by the Board of Governors a short time before. Issued subsequently, on May 3, was the fourth and final section, "Financing New Car Purchases: A National Survey for 1954-55." The accompanying article deals with some of the findings of the study as a whole. Readers interested in securing the report may order it directly from the Superintendent of Documents, U.S. Government Printing Office, Washington 25, D.C. Price for the full set is $6.20. Part IV may be obtained separately at $.60.

Moreover, the strong growth trend apparent in the long-term development of instalment credit has helped to make short-run contractions milder than they might otherwise have been. Expansion of credit thus has fortified upward movements, but contraction of instalment credit has not similarly intensified downward movements in over-all business activity.

In the course of adding fuel to booms, the growth of instalment credit has at times proceeded rapidly enough to intensify inflationary pressures. In doing so, it has taken its place among the forces general credit action has endeavored to counteract.

Is instalment credit self-regulating?

To the degree that instalment credit intensifies inflationary pressures and complicates the task of over-all credit control, it is not self-regulating. Or, at least, such capacity as it does possess to regulate itself evidently tends to weaken in the course of a business upswing.

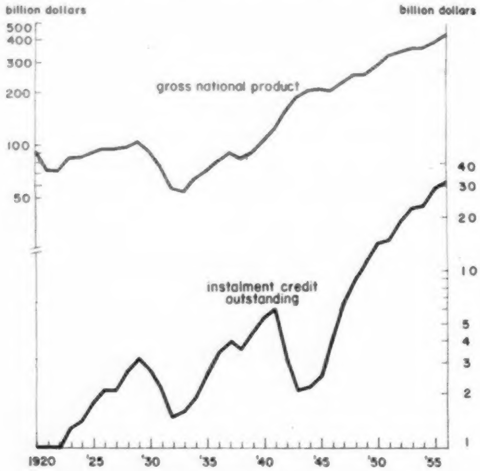
Yet, the problem has other aspects. What about lenders? Has their experience been such as to point up any failure of instalment credit to discipline itself?

Motivated by profit considerations, instalment loan agencies can be expected to exercise care in the screening of applicants for credit and, in any event, to see to it that finance charges are fully compensatory, that they are sufficient to absorb costs arising out of tardy repayment and the sale of repossessed collateral. Delinquency and repossession rates for recent years, as reported by major lenders, are reassuring. In 1955, for example, the delinquency ratios reported by commercial bank lenders for all types of instalment paper and for both personal and automobile loans, were lower than in any of the preceding seven years. Automobile repossession rates, reported for samples of sales finance companies, have been higher in the past three or four years than they had been immediately before, but they were lower in 1955 than in 1954. The relatively good showing for 1955 is interesting in the light of the relaxation in lenders' standards that was under way at the time. The stretch-out in contract maturities and the rather widespread reduction in required down payments, particularly noticeable in auto financing, failed to result in any deterioration in the performance of borrowers. There are indications, however, that at a given time repossessions run higher on low down payment contracts than on those calling for larger borrower equity. There appears on balance to be nothing in the record to suggest that lenders in the instalment credit field have had any undue difficulty. From their standpoint, in short, instalment credit seems to regulate itself satisfactorily.

On the surface, the picture from the vantage point of instalment borrowers is simply the other face of the coin. The relatively satisfactory delinquency and repossession loss rates experienced by lenders spell high-order performance by borrowers. Time buyers take their commitments seriously, even in times when personal income falls and unemployment moves up.

Yet this is not the whole story, for it fails to show the "cost" of instalment borrowing in terms of its impact on the household budget.

Instalment debt since World War I: three upsurges, two contractions mark advance greater than economy's



SOURCES: GNP, 1920-28, R. W. Goldsmith, *A Study of Saving in the United States*, III, 427; other data, U. S. Department of Commerce and Federal Reserve estimates.

Findings

After the accompanying article had gone to press, the Board of Governors of the Federal Reserve System issued the following statement setting forth its views with respect to the regulation of consumer instalment credit:

(1) The use of consumer instalment credit for the purchase of costly durable goods and in the management of family finances has penetrated a widening range of income receivers and social groups. The pace of penetration, however, has been sporadic.

(2) In the past, the rate at which consumer instalment credit was granted varied considerably. These variations tended to coincide with general fluctuations in economic activity.

(3) Though of recognizable importance as a factor of instability, fluctuations in consumer instalment credit have been generally within limits that could be tolerated in a rapidly growing and dynamic economy.

(4) A possible exception to the third finding occurred during the 1954-56 upswing in economic activity. The rapid expansion of consumer instalment credit in 1955, with its accompanying secondary impacts on capital investment, contributed to the emergence of inflationary pressures. This expansion, however, combined with real estate mortgage and other types of credit expansion in producing this sequence of developments.

(5) Since early 1956, expansion in total instalment credit has moderated, in part as a result of general monetary restraints and in part as a result of reduced demand for automobiles and other consumer durable goods commonly financed by instalment credit.

(6) Liberalization of instalment credit terms and standards from mid-1954 through 1955, which was particularly marked in connection with the purchase of new automobiles, contributed to further widening of the practice of instalment buying and borrowing and to the very great expansion in instalment credit outstanding that occurred. Some of the forces making for this rapid widening of the market for consumer credit were temporary. Also, this drastic liberalization of credit terms and standards exposed consumer lenders to increased risks. On both counts, the forces making for credit liberalization in that period were to an extent transient and self-limiting.

(7) Because of economic and social factors likely to affect the future of instalment credit, its growth in the years ahead may be at a slower pace than in the past. The volatility of consumer instalment credit in the past was to some extent related to its rapid growth. If future growth is slower, the potential instability of this factor may be contained within tolerable margins.

(8) Under peacetime conditions, special regulation of consumer instalment credit would inevitably present problems of compliance to the financing and business concerns subject to it, and of administration and enforcement to the agency of Government responsible for the regulation.

On the basis of the foregoing findings, the Board of Governors believes that a special peacetime authority to regulate consumer instalment credit is not now advisable. The Board feels that the broad public interest is better served if potentially unstabilizing credit developments are restrained by the use of general monetary measures and the application of sound public and private fiscal policies.

If the head of the family loses his job and instalment obligations continue to be met, something may have to give elsewhere: expenditure for food or for medical care conceivably may be cut back. Whether this is "desirable" or not is hardly the kind of question that can be answered categorically. Personal judgment is involved. And, in any case, who can decide more expertly than those directly affected? It is true that many people have a way of getting themselves almost inextricably bound up in debt, sometimes because they are not aware of all the conditions on which their credit is granted, frequently because of simple mismanagement. But some people spend their current incomes in ways that others will consider foolish, also. It is to be doubted that the community at large can do or ought to try to do too much to protect people from themselves, except where the repercussions are widespread and have important social implications.

Responsive to general measures?

An alleged lack of responsiveness of consumer credit to over-all credit measures forms the basis for one of the commonest arguments for

regulation. The lion's share of instalment credit, roughly 62 per cent at present, is provided by institutions, such as sales finance companies, credit unions and retail dealers themselves, which lie outside the banking system and thus to some extent beyond the reach of central-bank action. Moreover, so the argument runs, the yield on instalment paper in a period of expanding business is sufficiently attractive to investors, compared with returns on alternative investments, that general credit restraint tends to affect business, mortgage and governmental borrowers sooner and to a greater extent than it does consumer instalment borrowers. Furthermore, restrictive action which tends to increase money rates is said to exert little leverage on instalment credit since interest makes up only a small part of the finance charge in the typical instalment contract.

General controls imply that the Reserve System will keep an eye on credit developments taking place in all sectors of the economy but bring its influence to bear only on the total amount of credit available to all the sectors combined. It remains the function of the market to allocate credit among borrowers. This method of credit control places the Federal Reserve one stage removed from individual borrowers and borrower groups. If, for example, the construction industry becomes restive under the conditions on which it is able to secure credit accommodation, it has only to make a more appealing case to lenders to bid credit away from other users.

At the other extreme are devices the System might use to exercise selective control over the use of credit, sector by sector, and on the provision of credit by particular types of lenders. Under this method, the Federal Reserve would necessarily assume some the the duties of the market. Borrowers, as a result, would be placed in the position of having to look to the Federal Reserve as the ultimate source of their credit.

Significantly, one of the findings of the consumer instalment credit study was that general credit measures, in the period since 1951 at least, have had definite repercussions on the fund-raising abilities of major types of nonbank lenders. Because these lenders themselves depend in great measure upon banks, monetary action influencing the terms and availability of bank credit affects the conditions under which the nonbank lenders are able to operate and thus can indirectly condition the accommodation which they extend to their customers.

Regulation from the practical side

The policy choice, of course, need not be confined to these two alternatives. Some combination of them might be more suitable than either one by itself. Thus, some proponents of selective regulation assert that it is a needed supplementary tool that ought to be provided as a safeguard against "excesses" confined to instalment credit. The tools of Federal Reserve action — raising discount rates, selling securities in the open market or raising the levels of required reserves — would tend to restrain expansion or force contraction of credit throughout the market, notwithstanding that the situation in need of correction were confined to the comparatively insensitive field of instalment credit.

Selective regulation is, of course, a formidable task from an operating standpoint. About 200,000 separate establishments — banks, sales finance companies, credit unions, personal loan companies and dealers in durable goods — lie within the scope of supervision, to judge from experience with Regulation W. In peacetime, moreover, the patriotic motivation to comply is largely absent. This would complicate greatly the job of enforcement.

Inevitably, particular types of lenders and dealers and particular classes of buyers would feel they were being discriminated against. Merchants featuring credit sales and catering via easy terms to peripheral segments of the retail market would be harder hit by a cutback in contract maturities or an increase in required down payments than those who consistently adhered to conservative standards, not to mention merchants selling on a strictly cash basis. Similarly, individuals using credit freely would feel the pinch sooner than cash buyers.

Yet, discrimination of these sorts is not an exclusive feature of selective regulation. General restraint has a comparable discriminatory impact: it also tends to inconvenience users of credit while leaving cash buyers largely unaffected.

Instalment credit and the future

Whatever is in store by way of a long-term growth trend in instalment debt, it seems quite likely that marked fluctuations in the amount outstanding, and possibly further changes in lenders' terms, will continue to be experienced. Thus, many of the issues that gave rise to the Federal Reserve study will likely survive.

For the present, however, with comparative quiescence in the behavior of instalment credit, concern over the regulation issue has abated somewhat. General credit controls appear to be doing effectively the job cut out for them. It is quite possible, though, that tomorrow's environment will differ substantially from today's, and in that instance the issue of supplementing general monetary controls by resort to instalment credit regulation would likely be considered again.

Even so, as the record put in perspective by the study clearly shows, there are no hard-and-fast conclusions that can be depended upon to provide guidance for all time. And, whatever the decision at any particular time, it is clear that the choice will not afford a course that can be pursued costlessly. In the balance will be a host of advantages and disadvantages associated with each of the alternatives. The report seems to establish that the realm of instalment credit does lie one stage removed from the orbit of general credit control and that the down payment and maturity aspects of instalment contracts are at least as influential as the cost of money in setting the bounds on credit use. Hence, it would appear that selective regulation could play a useful role at any time developments in this sector tend to impart unstabilizing forces to the economy, be it peacetime or emergency. Yet the interferences with individual preferences and with the predilections of lenders inherent in such measures could be too high a price to pay for the degree of added precision piecemeal regulation might provide, except possibly in the most pressing circumstances.

Farm loans in the Midwest

Farmers' total cash outlays, ranging from 35 to nearly 45 billion dollars annually in recent years, have been party financed by annual additions to farm debt. Estimated currently to total about 18 billion dollars, total farm debt has more than doubled in the past decade. Commercial banks, reflecting their important role as a source of agricultural loans, have provided about one-third — 3.1 billion — of the nearly 10 billion increase since early postwar. This large rise in the total amount of farm credit outstanding and the important role of banks in providing it were important factors prompting the Federal Reserve System to undertake a nationwide survey of bank loans to farmers in mid-1956. A similar survey made in 1947 permits some comparisons to be made in bank credit arrangements over a nine-year period of rapid change in farm technology and financial structure of the industry.

Loan size and purpose change

Among the most striking changes affecting bank credit to farmers in the Midwest is the larger cash outlay for operating expenses. Since 1947 production expenses per farm have risen

nearly 50 per cent, and capital outlays for buildings, land improvements and farm machinery have increased even more. The gains reflect both a larger quantity of goods and services bought and higher price tags.

Paralleling these changes in farmers' outlays has been a 45 per cent boost in the average size of loan made by banks. Moreover, in mid-1956, 57 per cent of the bank credit outstanding to Midwest farmers was for the purpose of purchasing or improving farm real estate and to buy machinery, consumer durable goods and foundation livestock. While data are not entirely comparable, loans for these purposes are estimated to account for a somewhat larger portion of all bank credit extended to farmers than a decade earlier. The use of credit to finance capital expenditures was probably even larger during some intervening years when farmers added most rapidly to their machinery inventories and livestock prices were higher relative to prices of other goods than in recent years.

Financing capital expenditures

Along with the increase in relative importance of credit to finance capital outlays, there has been some increase in the importance of term loans. Whereas only 16 per cent of the number of loans outstanding had maturities of over one year in 1947, the 1956 survey turned up a figure of 22 per cent. Moreover, virtually all of the indicated increase in longer-term loans occurred in the intermediate-term group (from one to five years); there was only a small change in the proportion of loans with maturities of over five years.

Despite the increased number of loans with maturities of over one year, the dollar amount of this type of credit, 35 per cent of total outstandings, is small in relation to the indicated use of borrowed funds for financing capital outlays. However, in any appraisal of the adequacy of term credit, it should be recognized that the financial condition and earning capacity of many farmers is such that they may desire to repay funds for investment programs on a short-term basis. In addition, renewals and overlapping of maturities of loans written for relatively short terms also play an important role in financing farmers' investment programs.

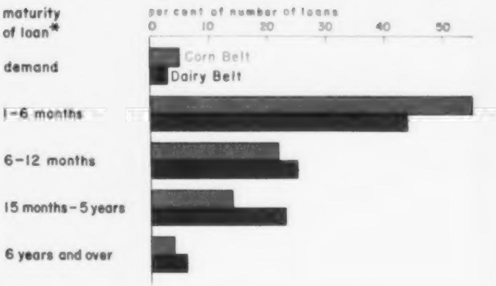
In mid-1956, 40 per cent of the farm borrowers at banks were reported to have been continuously in debt for two and a half years or longer — over half had been in debt for more than one and a half years. As less than one-fourth of the number of loans carried maturities of over one year, it is apparent that many of these "credit lines" resulted from renewals and the "piecing together" and overlapping of short-term notes.

Borrowers continuously in debt for over one and a half years had on the average two notes outstanding and in the aggregate 40 per cent of these notes had been renewed one or more times. On the other hand, borrowers who have been using bank credit continuously for less than one and a half years had on the average 1.3 notes outstanding and only 15 per cent of all of these notes had been renewed. For both groups of borrowers 60 per cent or more of the renewals were reported to have occurred by plan, i.e., there had been an agreement between the banker and the farmer at the time the loan was made that it could be renewed when due.

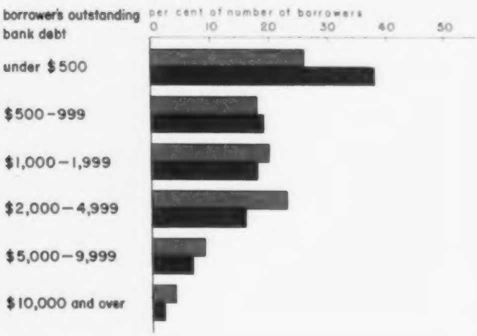
The large number of farm borrowers "continuously" in debt suggests that banks are supplying a considerable volume of intermediate-term credit through their programs of multiple loans to individual borrowers and renewals of short-term notes. Many Corn Belt banks apparently feel the need for the flexibility that this arrangement permits, and many farmers find it advantageous in accommodating "last minute" changes in marketing or expenditure plans. Related to these practices and the sporadic nature of receipts in the Corn Belt, over 80 per cent of the loans are scheduled to be paid in a lump sum.

In the Dairy Belt, however, loan maturities are frequently for longer periods, but the continuous nature of bank borrowing is still present. In this area the flow of income is relatively more stable; time deposits account for a higher portion of country bank liabilities; and longer

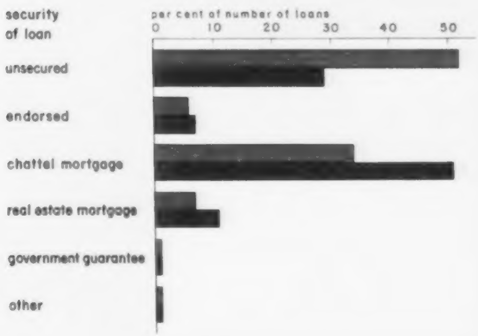
Bank loans to farmers have longer maturities in the Dairy Belt than in the Corn Belt;



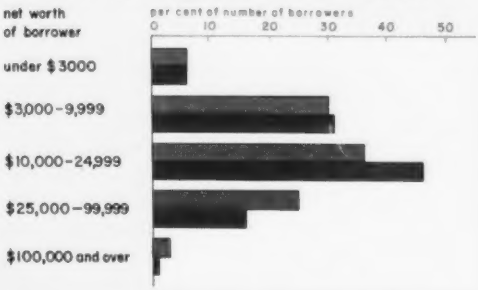
. . . borrowers debts are smaller in the Dairy Belt



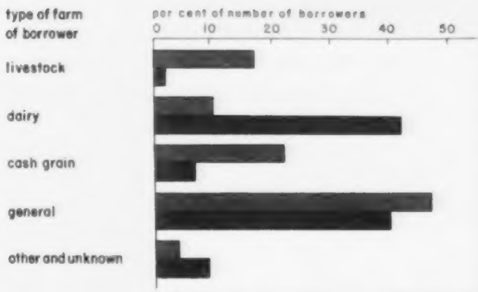
. . . and fewer loans are unsecured



These characteristics are related to differences in the "financial size" of farm borrowers in the two areas



. . . and to differences in the type of farming



* Loans are classified under the nearest maturity listed

Reflecting the lower risk, borrowers of large financial size obtain more "unsecured" loans, larger loans and at lower rates——1956

Security of loan	Under $3,000	$3,000-9,999	$10,000-24,999	$25,000-99,999	$100,000 and over
	Farm borrower's net worth				
	(per cent of number of loans)				
Unsecured	27	33	43	63	80
Endorsed	18	9	5	4	2
Chattel mortgage	51	51	41	22	7
Real estate mortgage	1	5	10	10	9
Other	2	2	1	1	2
	100	100	100	100	100
Average size of loan	$600	$785	$1,230	$2,120	$4,650
Average rate of interest	6.6	5.9	5.8	5.4	5.0

loan maturities and instalment notes are used more widely.

Borrower characteristics differ

During the past decade, Midwest farming has become more specialized. And farm borrowers at commercial banks reflect this shift: borrowers whose farms are classified as "general" account for a smaller portion of the total credit outstanding, and specialized livestock and cash crop farmers account for a larger portion. As a result, some banks probably have found that their farm loan portfolio has changed in character. Cash grain and livestock-feeding farms typically use larger amounts of credit and relatively more for the purpose of financing current operating expenses than do dairy or "general" farms.

But probably a more important factor influencing the characteristics of the credit extended by banks is the equity position of farm borrowers. Between 1947 and 1956 there was a substantial upward shift in the typical farm borrower's net worth. Whereas the greatest number of borrowers in 1947 had net worths of 3,000 to 10,000 dollars, in 1956 the greatest concentration of borrowers occurred in the 10,000 to 25,000 dollar bracket.

The USDA's balance sheet of agriculture also shows a substantial increase in farmers' equities over the period. Between 1947 and 1956 the average net worth per farm in the U.S. increased 70 per cent to over 30,000 dollars.

In view of these gains in the net worth of farm borrowers, it is perhaps not surprising that the security characteristics of Midwest farm loans underwent little change between 1947 and 1956 despite a decline in farmers' profit margins. In both survey years, nearly 45 per cent of the farm loans in the portfolios of District banks were unsecured in the sense that no specific asset or endorsement was provided as security. Chattel mortgages were somewhat more prevalent in mid-1956 than a decade earlier, 40 per cent of all notes compared with 31 per cent. Part of the increase probably reflects the greater frequency of loans for the purpose of financing machinery and consumer durable goods, items on which a chattel mortgage is used as security for nearly 75 per cent of the notes. Other kinds of collateral, primarily real estate and endorsements, were somewhat less prevalent than in the early postwar period.

Loans to "small" farmers

"Financial size" of the farm borrower is, of course, an important consideration to bankers in granting loans. While farmers who have accumulated substantial amounts of capital usually have no difficulty in obtaining credit, and on relatively favorable terms, borrowers with small equities present a more difficult problem. However, survey results indicate that banks in their current lending programs do allocate considerable amounts of their funds to farmers having small net worths.

In mid-1956, 55 per cent of the non-real estate farm credit outstanding at banks was to borrowers with net worths of less than $25,000, who together had less than 35 per cent of all equities of bank borrowers. At the other end of the scale the "largest borrowers" obtained about 45 per cent of the total funds loaned, but together they had 65 per cent of the total equities of bank farm borrowers. Reflecting the smaller size of business and the greater risk in loaning to farmers with small equities, loans to these borrowers usually are smaller, and fewer are unsecured. Partly as a result of the greater risk involved and the higher cost per dollar of handling small loans, interest rates are higher (see table).

As banks grant a high proportion of credit to farm operators who together account for a relatively small part of the equities of all bank borrowers, it is not surprising to find them active lenders to young farmers and to tenants. As shown by the following table, loans to young farmers and tenants were found to occur in bank loan portfolios in about the same frequency as these operators are found on the rural landscape.

Age of operator	Bank borrowers	Number of operators[1]
	(per cent of total)	
Under 25	2	2
25-34	17	15
35-44	36	24
45 and over	45	59
Total	100	100
Tenure of operator		
Owner-operator	71	76
Tenant	29	24

[1] Data from the 1954 Census of Agriculture.

Market penetration

Midwest banks, besides supplying credit to all types and "sizes" of farms and to tenants and young farmers, have boosted the number of farm loans outstanding by 75 per cent since 1947. This increase has occurred during a period in which the number of Midwest commercial farms declined by 17 per cent. It is estimated that two out of every three farmers in the Seventh District had bank credit outstanding in mid-1956. Moreover, it is probable that the number of farmers who use bank credit sometime during the year is even higher. This is particularly true in areas where fall purchases of feeder cattle result in a large volume of new borrowings at that time, and some of those customers no doubt were not using credit at midyear when the survey was made.

Current trends toward larger farms, greater investments in capital equipment and mounting cash outlays for operating purposes apparently will maintain a strong demand for farm credit in the years ahead. Bank debts currently average about $2,400 per farm borrower in the Corn Belt and $1,800 in the Dairy Belt. Perhaps even more indicative of the large use of credit by some farmers is the number of borrowers having debts of $2,000 or more. In the Corn Belt over 35 per cent of the farm borrowers had outstanding loans at their banks for at least this amount, while in dairy areas only 25 per cent of the farm borrowers had loans totaling $2,000 or more. The larger debts among Corn Belt farmers than dairy farmers reflect the larger capital requirements per farm and the more erratic seasonal flows of income and expenditures.

In addition, larger bank debts in the Corn Belt than in the Dairy Belt reflect the larger financial size of borrowers. Whereas 26 per cent of the farm borrowers in the Corn Belt had net worths of $25,000 or over, in the Dairy Belt only 16 per cent of the borrowers had net worths of over that amount.

Business Conditions *is published monthly by the* FEDERAL RESERVE BANK OF CHICAGO. *Subscriptions are available to the public without charge. For information concerning bulk mailings to banks, business organizations and educational institutions, write: Research Department, Federal Reserve Bank of Chicago, Box 834, Chicago 90, Illinois. Articles may be reprinted provided source is credited.*

Fringe benefits at Midwest banks

Between 10 and 30 per cent of the total labor cost of most Midwest banks is attributable to expenditures other than direct wage and salary payments — the so-called fringe benefits for employees. Found in relatively few business firms before World War II, and then in modest amounts, fringe benefits have grown to be a substantial proportion of labor cost in most types of business establishments. The extent to which banks have participated in this trend and the relative importance of the various types of benefits for employees of Seventh District member banks are evidenced by a survey made early this year by the Federal Reserve Bank of Chicago.[1] The kinds and costs of fringe benefits provided these workers are summarized in this article.

What are "fringes"?

"Fringe benefits," of course, mean many things to many people. For the purpose of the survey they were defined as the employing bank's share of all *voluntary* expenditures other than basic wages and salaries which primarily benefit employees without necessarily entailing greater productivity on their part. Expenditures required by law — notably social security and workmen's compensation assessments — were excluded because they are not provided at the discretion of the employer and vary only modestly from one bank to another.

Fringe benefits can be divided into three general groups. First, there are payments for time not worked: vacations, sick leave and some other excused absences. Another major category consists of contributions to provide for employee security: medical and life insurance programs and pension plans. The third category consists of the miscellaneous benefits, such as bonuses, net expenses of an employees' cafeteria, educational subsidies and related items.

Time off with pay

Paid *vacations* are one of the oldest types of fringe benefit, and incidentally one found to be virtually universal among Midwest banks. Two-week vacations are typical for both officers and employees, regardless of the size or location of bank, although one week is often granted to employees with less than a year's service. Three-week vacations are generally granted only by larger banks and upon completion of about 10 to 15 years of service for officers and 15 years for employees. Vacations of four weeks or longer are not common. They are limited almost entirely to officers or employees in large city banks with a minimum of about 20 or 25 years of service.

Banking *holidays* are, of course, more numerous than those observed by most other businesses. They vary somewhat from state to state depending on custom and statute, but they are in almost all cases "with pay." With the exception of Indiana, where smaller banks observe about twice as many holidays as the larger ones, there is little variation in the number of paid holidays among banks within a state.

Most District banks grant time off with pay for *sickness* and a variety of other personal

The study summarized in this article — "Fringe Benefits of Seventh District Member Banks" — is available without charge upon request to the Research Department, Federal Reserve Bank of Chicago, Box 834, Chicago 90, Illinois.

[1] Sixty-four per cent of Seventh District member banks, representing banks in various size groups in each of the five District states, participated in this survey. The responses obtained from these banks indicate that the overwhelming majority of Midwest banks, both large and small, provide fringe benefits in one or more forms to their employees. Nevertheless, because of the greater likelihood of response from banks which have substantial fringe benefits, the incidence and cost of benefits are undoubtedly higher among respondents than for all banks.

reasons. At least 80 per cent of the banks tailor this leave to suit the individual circumstances as they arise. Although it may be considered a part of fringe benefits, in practice such leave is almost indistinguishable from basic salary. There are usually limits to the time span for which employees can be paid while not working, but these limits vary from bank to bank. Large city banks are most likely to consider personal excused absence with pay of sufficient importance to require definite policies and detailed records.

Health and security benefits

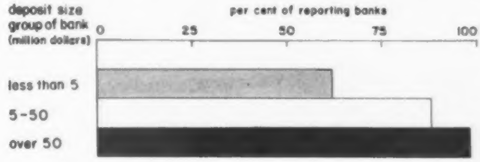
Not nearly so universal, but still impressively widespread, is the protection banks afford their employees in the form of hospital and medical insurance, life insurance and pension contributions to supplement social security. Although all three types of coverage are typically included in the "package" of fringe benefits provided by large banks, they become progressively less common as the size of bank declines (see chart). This is particularly true for *pension plans,* which are established in 98 per cent of large banks (those with over 50 million dollars of deposits) but in less than one-tenth of the smallest banks (those with less than 2.5 million deposits). For smaller banks the most common type of health and security benefit is *hospitalization* insurance, which is offered by almost half of even the smallest institutions.

For both hospitalization and group life insurance, the most typical practice is for the employing bank to pay the entire amount of the premium. Even pension plans are, in the majority of cases, financed without employee contributions, although this practice is more prevalent among small banks than among large ones. A wide variety of financing plans are in use. However, insurance company plans are the most popular. Contributions may be fixed or contingent on profits.

In general, a larger proportion of banks in Michigan and Wisconsin provide hospitalization insurance, group life insurance and pension plans than in Illinois, Indiana or Iowa. These differences may be explained in Michigan by

Nearly all the large banks offer a variety of fringe benefits

Hospitalization insurance is the most popular fringe benefit in all sizes of banks,



group life insurance is provided by a somewhat smaller proportion, and

pension plans are the exception rather than the rule in small banks although provided quite generally in the large banks

the necessity of competing in labor markets in which the fringe benefits included in contracts of many industrial unions bulk large. In Wisconsin a similar market pressure may exist, for employers there have been traditionally spurred to liberality by legislative action.

Other benefits

A number of banks furnished information about bonuses, educational subsidies, coffee breaks, employee recreation, etc., if they considered the cost sufficiently important. Since all banks were not specifically asked about these items, and may not even consider them as fringes, it is difficult to generalize about their importance.

Bonuses, however, were mentioned by about 60 banks as an important element in their fringe

benefits. Sometimes regarded as part of basic salary, they have been included here as fringes because they depend upon an annual decision by a bank's board of directors.

Costs of fringe benefits

Roughly half of the banks responding to the survey supplied information on their fringe benefit costs. These data indicate that the costs of vacations, holidays and other "time off with pay" are of about equal importance for all banks, regardless of size or location. The most expensive time-off item is vacation pay, which amounts to about 3½ per cent of total wage and salary expense. Sick leave pay accounts for another 1 per cent for most banks. Pay for other time off is not generally considered to be a significant item.

By contrast, the health and security type benefits appear to be relatively more costly for the smaller banks. This is illustrated in the table below which gives the average ratio of the cost of selected benefit items to total labor cost, salaries and wages plus fringe benefits, for small and for large banks.

	121 "small" banks (under 5 million deposits)	25 "large" banks (50-200 million deposits)
	(in per cent)	
Hospital and medical-surgical insurance	1.5	.8
Group life insurance	1.3	.8
Funded pension plans	7.2	4.4
Bonuses and other profit-sharing plans	9.8	5.5

Part of these differences undoubtedly reflect differences in the share of the total premiums or contributions paid by the bank. For example, although pension plans are relatively rare in small banks, where they do occur they are more often financed entirely by the bank. Also, of course, it is reasonable to assume that larger banks enjoy a saving in the cost per covered employee of financing these security benefit programs. Furthermore, the generally higher basic wage rates in the large banks reduce the relative importance of the auxiliary items.

The high absolute cost of pension plans is probably a strong deterrent to their establishment among smaller banks. Their cost ranged from an average of 7 per cent of total labor expense in small banks to 4 per cent in the large banks. Hospitalization and group life insurance premiums on the other hand are much smaller.

Where bonuses or profit-sharing plans are used, the cost represents a relatively high proportion of total wage and salary expense. (No attempt was made in this survey to determine whether basic salary and wage rates tended to be higher or lower for banks providing bonuses and profit sharing as a part of their compensation plan than for those not providing such plans.) While banks may provide more money currently by means of bonuses, these do not entail fixed commitments as do retirement programs. By their very nature, bonus costs would be reduced in a less profitable period.

The typical ratio for total fringe benefits for the banks which reported cost information in the survey was between 15 and 20 per cent of total labor cost.

Cost of fringe benefits as percentage of total labor cost	Percentage of reporting banks
less than 10	0
10, but less than 15	20
15 — 20	36
20 — 25	25
25 — 30	12
30 or more	7
	100

It is apparent from this survey that Midwest banks are typically conscious of the benefits of the "fringe benefit package" as an incentive to stable employment. Large banks, almost universally, provide programs to protect employees against major financial risks. Such coverage is much less common among the smaller banks, but these banks typically pay a large portion of the cost of such programs. While large organizations are usually in a better position to pioneer new things, if past patterns can be trusted to recur, these employee benefit programs can be expected to spread to more and more banks, particularly if high-level business activity is maintained.